

Real GDP Formula

Real GDP is said to be the value of all goods and services determined in an economy after taking into account the rate of inflation.

In other words, it is the inflation adjusted value of goods and services produced in an economy in a year, therefore it is also known as inflation adjusted gross domestic product.

Real GDP in addition to inflation also takes into account the deflation. Real GDP is therefore a more accurate measure of the economy than the other measures, such as Nominal GDP (which measures total output based on the prices).

The Real GDP formula can be represented as

Real GDP = Nominal GDP / Deflator

or $R = N / D$

N or Nominal GDP = C + I + G + (X - M)

D or Deflator = Nominal GDP / Real GDP

Where,

C = Consumption

I = Investment

G = Government spending

X = Exports

M = Imports

Advantages of Real GDP

1. It allows comparison of GDP by year as it takes inflation into consideration
2. It is a good measure of the state of economy in a business cycle
3. Real GDP helps economies prepare for making good financial decisions or for recessions